RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 28, 1989 **LETTER 1020**

June 16 DJIA 2486.38; PTI 3086; A-D Ratio -7.63
June 23 DJIA 2531.87; PTI 3095; A-D Ratio -7.42
Current Dow Yield: 3.57%; Dow P/E: 11.0
Dow Book Value: 1009; Dow 200-day MA: 2255;
Dow Pow: 1022
Percentage of Undervalued Blue-chips: 16%

THE MARKET: Whoosh! That's the way it went, last Friday, June 23, as the Dow surged to a new recovery high (not a new high above the 1987 high, but a new post-crash recovery high). At the same time the Transports rallied to new all-time highs, and thus we have one of the strangest and most exotic price structures seen in many a year.

Will the Dow, still almost 200 points below its August '87 high of 2722.42 confirm? Or is this one of the biggest fake-outs in modern market history? That's the major question, and only time itself can provide the answer.

My Primary Trend Index (PTI) continues to be the hero of the game (see page 2 chart). It is again at new highs. So despite all non-confirmations, news-shocks, dollar fluctuations, and bond gyrations, the PTI has remained stubbornly on the up-escalator. It's still there, and until it turns down and breaks below its moving average, the pressure on the market will be to the upside.

Primary Trend: In listening to hundreds of TV and radio comments and reading many dozens of advisories, I note that the one item missing is a discussion of the primary trend of the market. This is the most fundamental of all market considerations, yet it is the one least understood.

Let me outline the significance of the primary trend again. The primary trend of the market can be likened to the tidal action of the ocean. When the tide comes in, it will carry everything along with it (85% of all stocks advance during the course of a bull market). Conversely, when the tide runs out, it will take the great majority of stocks down with it (the percentages are roughly the same on the downside).

The true direction of the primary trend is written in stone (it always is). But at present there are many arguments as to whether the primary trend of this market is bullish or bearish.

If it's true that the great bull market ended in August 1987 -- then at no time are the D-J Industrial and Transportation Averages fated to jointly better their 1987 highs; in due time, the market will fall apart. But if the 1987 crash was an aberration, an unprecedented "interruption" in an ongoing bull market (as most analysts now claim), then it is just a matter of time before the Dow betters its 1987 bull market high of 2722.42. And just as surely, the majority of stocks will follow the primary trend to higher levels.

As readers know, I am of the opinion that the bull market ended in 1987, and that all the action since then has been part of an extended secondary correction. On that basis, regardless of better business, mergers, takeovers, asset plays, presidential hopes and Fed manipulations, I do not believe we will see a new high in the Dow. Instead, I believe that somewhere ahead the bear will surface -- and he'll hold Wall Street and the nation in his grip again. Furthermore, because the primary (bear) trend has been held back for so long, it is my guess that when the bear forces finally do reassert themselves, the downside action will be that much more severe.

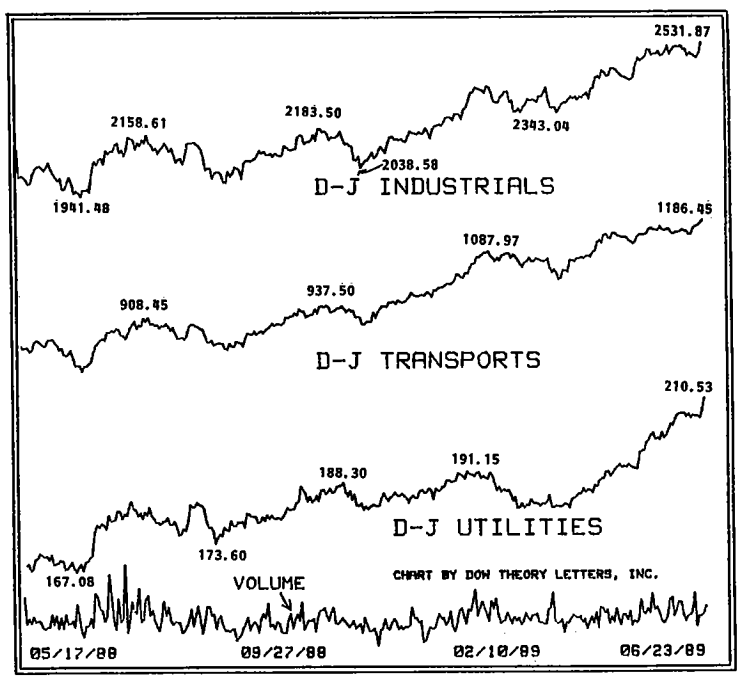
The kickers in the Transportation Average are the airline stocks. As an added observation, the airlines (the glamour stocks of today) are now commanding huge prices with many of the carriers surging 5 points or more in a day (in 1974 most of the airlines were selling at prices ranging from 3 to 15). These stocks are no longer analyzed on the basis of earnings or potential earnings but rather on what their assets are worth if those assets were for sale.

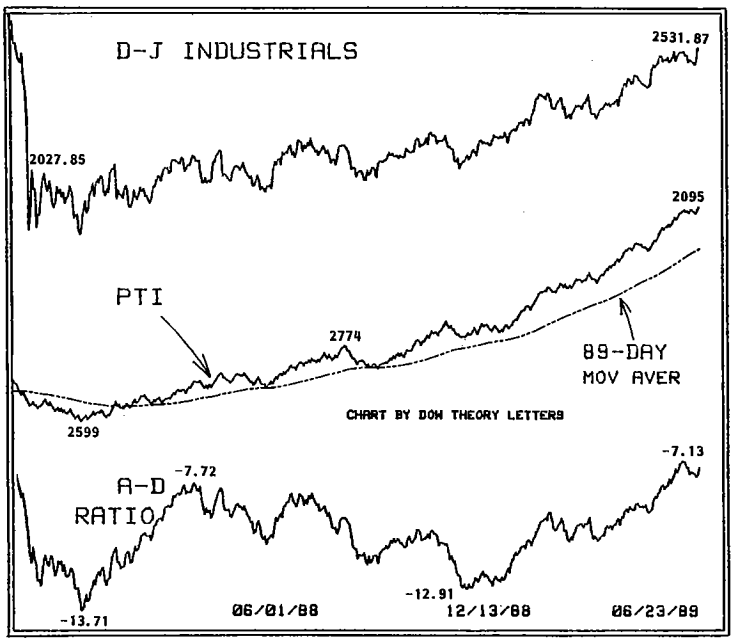
As for today's prices for the airline stocks, I might remind subscribers that the airline industry is one of the most cyclical of all industries, and historically when the economy turns down, airline stocks have collapsed. For instance during 1972-74, AMR (American) dropped from 50 to under 10. During the same period UAL (United) dropped from 54 to 14. As another point of interest, the yield on the D-J Transportation Average is now 1.47%. Nuff said.

THE REST of the PICTURE: As I explained in the "Investment Position" section of the last Letter, the way I personally have made money in the markets over the years is based on classic Dow Theory strategy. That entails buying stocks (or bonds) when they are great values, and selling them when they become overpriced.

In medicine (according to the Hippocratic oath), the first law is "Do no harm." In investing, Russell's first law is "Lose no money." The surest way of obeying that law is to buy great values under the principles of Dow Theory. This is a lesson I learned from the works of Charles H. Dow. But this lesson was brought home to me even more forcibly by my mentor, George Schaefer, the great Dow Theorist of the 1940s to '70s.

I have written about the "lose no money" thesis a number of times, and along those lines I must say that the current period reminds me





very much of the 1966-74 era. A great bull market topped out in 1966. The bull market was followed by a long and confusing series of major rallies and declines. On a number of occasions one or the other Average rose to near their 1966 highs. Finally, in January of 1973 the Dow rallied to a new record high (although the Transports failed to confirm by a wide margin). Following the 1973 peak, the market lapsed into one of the worst bear market declines in history, a decline that ended in December 1974 with the Dow at 577.60.

What about the current situation? On the face of it, it would appear that corporate America is one big asset play, and if you're a public corporation you're fair game. Behind the whole takeover syndrome is the ease with which raiders and takeover specialists are able to raise debt money, plus the US tax system which allows individuals and corporations to write off the interest on debt. Day after day the most-active list on the NYSE is dominated by takeover situations while rumors of additional new takeovers fill the air. I have't seen anything like it since the frenzy to buy science stocks during 1967-68.

Last week *Money* magazine called to ask me if I would describe why I believed this was still a bear market. I told them that under Dow Theory, once a bull market hits its peak (which occurred in 1987), the bear takes over. The bear market continues until stocks have discounted the worst that can be seen ahead. "How do you know when you've arrived there?" asked *Money* magazine. "Great values," I answered, "stocks decline to the point where they represent great values. Furthermore, at a bear market bottom, the public is totally disenchanted, Wall Street sentiment has turned black, volume is extremely low, yields on blue-chips are high. And most important -- the market becomes immune to bad news. Those are the conditions that prevail at a true bear market bottom. And we haven't seen anything like that -- yet."

Again I repeat that at the August 1987 highs the market displayed all the characteristics of a primary bull market top -- minuscule yields, high volume, rampant speculation, wild rumors, predictions of "Dow 3600 to 4000," plus glaring signs of technical deterioration.

Once a bull market tops out, (regardless of gyrations, double tops, new highs in one Average, Presidential edicts, Fed manipulations or Congressional machinations) the bear takes over. Once that occurs, the bear market will remain in force until the Averages have discounted the worst that can be seen ahead.

As I see it, the 20 months since the crash lows have been among the most deceptive in stock market history. Sentiment during those 20 months has turned from pessimism to optimism. Many stocks have approached their old highs and some have even rallied to new highs. Breadth during the entire rise has been erratic (this can be seen in the strange, sluggish action of DowPow).

Three important market bellwethers, however, have not joined the bull camp. Those three are IBM, GM, and the D-J Utility Average. IBM and GM are now well below earlier highs. The Utility Average recorded its bull market high of 227.83 back on January 22, 1987 -- seven months before the final market top. It has not been back there since.

* * *

Do you watch TV or listen to the radio? Do you read the newspapers? Well then, welcome to the best-advertised collapse in interest rates in history! The swoon in interest rates is slated to materialize in the period directly ahead.

But have a a care. On June 16 the latest Consumer Price Index figures were released. Surprise, up 0.6% in May for an annual inflation rate of over 7%. Which points to the thesis that the much-hoped for "soft landing" may not materialize, or at any rate it may not be enough to head off inflation.

So Mr. Greenspan and the Fed must continue walking the line, not knowing for certain whether they should be tightening or easing credit. My own guess is that barring a true recession, inflation will be heading up again -- probably before the end of the year.

Normally, this is the year (i.e., the year after the election) when the Administration would take a recession, figuring that they could fire up the economy in 1990-91, in plenty of time for the next presidential election in 1992. Ah, but there's a catch. That catch is called "too much debt." A real recession now would send many over-leveraged corporations into bankruptcy, a situation the Fed is only too well aware of.

ITEMS: Speaking of too much debt, on June 15 *Integrated Resources* toppled into bankruptcy, and the *New York Times* put it this way: "The company has been a heavy issuer of high-yield junk bonds and was hailed in April at Drexel Burnham Lambert's annual junk bond conference as one of the companies that owed its success to such financing. That opinion was widely shared on Wall Street. Last week some of the company's bonds sold at 28 cents on the dollar." The *Times* added that bids for the bonds were less than 25 cents but that they did not know of any transactions at those levels. . . . The plunge in the company's stock price came only a few months after founders Jay and Selig Zises sold the bulk of their holdings at $21 a share, far above the market price.

On June 20 money-losing, debt-ridden Harcourt Brace announced that it was selling off its profitable entertainment division including Sea World in an effort to reduce debt. And Time-Life, which has always been adverse to debt, was offering to buy Warner Communications for up to $14 billion, an offer, which, if it goes through, will load Time with a choking amount of new debt.

Remember, all the above is happening during "good times." You can imagine (and I'm sure the Fed is imagining) what would happen if even a mild recession entered the picture.

But the beat goes on. On June 16 Dan Dorfman (*USA Today*) interviewed John Tozzi of Cambridge Investments, a specialist in takeover stocks with a $200 million bundle to play with. "Will the game go on?" asks Dorfman. "It's got to," Tozzi says. "The appetite for US assets by raiders, foreigners and the soaring number of leveraged buyout funds is just insatiable. What's more, interest rates have dropped sharply, making it easier to finance deals."

That seems to be the attitude as the breakup and takeover of America's corporations goes on -- and as billions of dollars of new debt pile up. It's the leveraging of America, there's no other way to put it.

In my opinion this whole process is placing the US in the most fragile financial condition in modern history. Ultimately, the bear will re-emerge accompanied by a recession or depression in the economy. At that time I expect to see what I term "the re-liquefications of America." The re-liquefication will materialize out of an absolute avalanche of bankruptcies.

Final Item: This piece was from the latest issue of *Crane's New York*. And I wonder if Gotham isn't providing us with a glimpse of things to come.

BY ALAN BREZNICK
CRAIN'S NEW YORK BUSINESS

Although it's taken longer than many expected, the 1987 stock market crash has finally brought New York's economy to a virtual standstill.

In fact, a few regional economists are gingerly predicting a recession this summer as nearly every engine of the local economy sputters. Continued heavy job losses in banking, securities and manufacturing, combined with flat retail sales and construction and a sudden falloff in tourism, have sapped what little vitality was left when the year began.

"If we're not in a recession now, we expect that we will be by the third quarter," says the usually upbeat Rae Rosen, a regional economist for the Federal Home Loan Bank in New York.

INVESTMENT POSITION: What makes a man like Carl Icahn complete one super-profitable deal (he made $800 million on Texaco), and then jump right into another situation? I can only guess that it's his competitiveness plus the excitement of winning the game. What about you and me? Can you step out of a stock or bond position and rest -- in cash? Or do you have that irresistible, all-consuming urge for action? It took me a long time, but for better or worse I've learned to cool it. I've learned the secret of taking profits and then sitting tight.

What do I recommend now? Personally, I've taken large profits on bonds. I now have very little in any of the markets (a few no-load funds) and that's about it. My PTI continues to rise to new highs, and if it were not for that I'd be all in cash.

After rising for almost two years, the bond market is now being widely advertised as a sure-fire winner ("the coming recession will collapse interest rates"), and the stock market is supposedly good for "at least one more leg up." But by my reckoning, the stock market is overvalued, and that's a problem. Overvalued? Yes, the S&P 500 is selling at 29 times dividends, only 16% (a new low) of the blue-chips on the NYSE are now undervalued, and the Dow has been rising for seven consecutive years (it has never risen for eight years in a row).

So my own instinct is to play it safe and generally opt for cash. The wide expectation is that if there is anything resembling a recession coming up in the economy it will simply be "a soft landing." And if the market is making a top, it will, at worst, be a minor top, not requiring any defensive action on the part of stockholders.

But from a Dow Theory standpoint a major non-confirmation now exists with Transports having advanced to a record high, a high not confirmed by the Dow. The non-confirmation has been ignored or not taken seriously by most analysts, and I seem to be the only student in the country pointing to the danger of this situation.

I look at it this way. If a major top is forming here and six months from now the market is in tatters, Dow Theorists will be able to look back and say, "Ah, it was obvious, major non-confirmation. It couldn't have been clearer." Let me put it another way. If the Dow betters its 1987 high (thereby confirming the Transports), the bear gets yanked out of the box and a bull takes his place. At the same time I will admit to having been wrong about the primary trend. But it hasn't happened yet.

MAKING MONEY: I'm in touch with probably 50 leading investment advisors and publishers. These men and women make their living telling other people how to make money (usually, but not always, via the stock market). But here's the strange and ironic fact. Very few of these advisors have ever made a substantial amount of money for themselves (I know this for a fact). And I ask myself, "Why aren't they rich; why haven't they made money?" Of course, the answer is obvious. They haven't made money because they simply don't know how.

Making money entails a lot more than guessing which way the stock or bond markets are heading. For the great majority of people, making money requires a plan, self-discipline, and desire. I say, "for the great majority of people" because there are a few exceptions. If you're a Steven Jobs or a Ross Perot or a Steven Speilberg you don't have to know about the Dow or the markets or about yields or price/earnings ratios. You're a phenomenon in your chosen field, and you're going to make big money as a by-product of your extraordinary talent and ability.

But for the average person, for you and me, we have to have a plan. Here are a few items that I feel you and I must be aware of if we want to make money.

(1) We must have a knowledge of compounding. Compounding is the royal road to riches. Compounding is the safe road, it is the sure road, and it can be accomplished by anyone. To compound you need discipline, perseverance, intelligence and time. You need discipline so you can save, you need perserverance in order to stay on the path, you need time to allow the power of compounding to work for you. And you need intelligence in order to comprehend the fantastic rewards that compounding will bring you.

There's one catch in the compounding process. It's boring. Or I should say it's boring until (after seven or 10 years) the money starts pouring in. Then, believe me, compounding starts to become very interesting!

In order to emphasize the power of compounding, I am going to include a study that I published back in Letter 948 (the study is courtesy of *Market Logic,* 3471 N. Federal H'way, Ft. Lauderdale, FL. 33306).

In this study we assume that one investor (A) opens an IRA at age 19. For eight successive years he puts $2,000 into his IRA, and he obtains an average growth rate of 10% (interest plus growth). After eight years this fellow makes no more contributions -- he's finished. A second investor (B) makes no IRA contributions until age 27 (this is the age when the first guy ended his contributions). Then B contributes $2,000 each year until he's 65 (all at the same theoretical 10% growth rate).

As you can see, the absolutely incredible result is that A, who made his contributions earlier and only made eight contributions, ends up with MORE money than B who made 39 contributions, starting his contributions at a LATER TIME. This demonstrates the amazing POWER of compounding through time. The difference in the two investors' results is that A had eight more early years of compounding than B. Those eight early years were worth more than all of B's 31 additional contributions.

Have you ever wondered how some of the great American fortunes were made. I'll tell you. They did it though compounding at low or zero tax rates -- and through time. You can do the same thing. How? With top grade tax-free municipal bonds or with tax-free muni money market funds. All you need is a plan, discipline, a knowledge of compounding and time (by the way, you might show this study to your kids).

	INVESTOR A		INVESTOR B	
Age	IRA Contribution	Year-end Value	IRA Contribution	Year-end Value
19	$2,000	$ 2,200	-0-	-0-
20	2,000	4,620	-0-	-0-
21	2,000	7,282	-0-	-0-
22	2,000	10,210	-0-	-0-
23	2,000	13,431	-0-	-0-
24	2,000	16,974	-0-	-0-
25	2,000	20,872	-0-	-0-
26	2,000	25,159	-0-	-0-
27	-0-	27,675	$2,000	$ 2,200
28	-0-	30,442	2,000	4,620
29	-0-	33,487	2,000	7,282
30	-0-	36,835	2,000	10,210
31	-0-	40,519	2,000	13,431
32	-0-	44,571	2,000	16,974
33	-0-	49,028	2,000	20,872
34	-0-	53,930	2,000	25,159
35	-0-	59,323	2,000	29,875
36	-0-	65,256	2,000	35,062
37	-0-	71,781	2,000	40,769
38	-0-	78,960	2,000	47,045
39	-0-	86,856	2,000	53,950
40	-0-	95,541	2,000	61,545
41	-0-	105,095	2,000	69,899
42	-0-	115,605	2,000	79,089
43	-0-	127,165	2,000	89,198
44	-0-	139,882	2,000	100,318
45	-0-	153,870	2,000	112,550
46	-0-	169,257	2,000	126,005
47	-0-	186,183	2,000	140,805
48	-0-	204,801	2,000	157,086
49	-0-	225,281	2,000	174,995
50	-0-	247,809	2,000	194,694
51	-0-	272,590	2,000	216,364
52	-0-	299,849	2,000	240,200
53	-0-	329,834	2,000	266,420
54	-0-	362,817	2,000	295,262
55	-0-	399,099	2,000	326,988
56	-0-	439,009	2,000	361,887
57	-0-	482,910	2,000	400,276
58	-0-	531,201	2,000	442,503
59	-0-	584,321	2,000	488,953
60	-0-	642,753	2,000	540,049
61	-0-	707,028	2,000	596,254
62	-0-	777,731	2,000	658,079
63	-0-	855,504	2,000	726,087
64	-0-	941,054	2,000	800,896
65	-0-	1,035,160	2,000	883,185
	Less Total Invested	(16,000)		(78,000)
	Net Earnings	$1,019,160		$805,185
	Money Grew	64-fold		11-fold

(2) This might sound like a silly rule (believe me, it isn't), but if you want to be wealthy you must not lose money. Absurd rule, obvious rule, silly rule? Maybe, but MOST PEOPLE LOSE MONEY in disastrous investments, gambling, rotten business deals, poor market timing, etc. Yes, I can tell you in my 35 years as an advisor that most people very definitely DO lose money. Want to avoid taxes, never lose money and compound with safety? Easy, put your money in a municipal cash fund. You'll average 5% to 6% on your money year in and year out. Of course, this is a very boring procedure for most people, but somewhere along the line you have to decide whether you want excitement or wealth.

(3) About a year ago I wrote a piece entitled "Rich Man, Poor Man." I received dozens of letters about this piece, and many institutions asked permission to reprint that article. I consider the piece so important that I want to publish it again. So here goes:

RICH MAN, POOR MAN: In the investment world, wealthy investors have one major advantage over the little guy, the stock market amateur and the neophyte trader. The advantage that the wealthy investor possesses is that he DOESN'T NEED THE MARKETS. I can't begin to tell you what a huge difference that makes, both in one's mental attitude and in the actual handling of one's money.

The wealthy investor doesn't need the market because he already has all the income he needs. He has money coming in via bonds, T-bills, money market funds, real estate and stocks. In other words, the wealthy investor never feels pressured to "make money" in the market.

The wealthy investor tends to be an expert on values. When bonds are cheap and bond yields are irresistibly high, he buys bonds. When stocks are on the bargain table and stock yields are attractive, he buys stocks. When real estate is a great value, he buys real estate. When great art or fine jewelry is on the "give-away table," he buys art or jewelry. In other words, the wealthy investor puts his money where the values are. And if there are no outstanding values, the wealthy investor waits. He can afford to wait. He has money coming in daily, weekly, monthly. The wealthy investor doesn't need the market. He knows what he's looking for, and he doesn't mind waiting months or years for it if he has to (they call that PATIENCE).

What about the little guy? This fellow always feels pressured to "make money," to force the market "to do something for him." When the little guy isn't buying stocks at 3% or 2% yields, he's off to Vegas or Atlantic City trying to win at craps, or he's spending 10 bucks a week on lottery tickets, or he's "investing" in some crackpot real estate scheme with an outfit that his bowling buddy told him about (in strict confidence, of course). And because the little guy is trying to force the market "to do something for him," he's a constant, sure-fire loser. The little guy doesn't understand values so he always overpays. He loves to gamble, so he always has the odds against him. He doesn't understand compounding, and he doesn't understand money. He's the typical American, and he's perpetually in debt.

The little guy is in hock up to his ears, and he's always sweating -- sweating to make payments on his house, his refrigerator, his car or his lawn mower. He's impatient, and he constantly feels pressured. He tells himself he has to make money fast. And he dreams of those "big bucks." In the end, the little guy wastes his money in the market, he loses his money gambling, or he dribbles it away on senseless schemes. In short, this "money-nerd" spends his life dashing up the financial down-escalator.

Now here's the sad part of it, the ironic part of it. If, from the beginning, the little guy had adopted a strict policy of never spending more than he made, and if he had taken that extra income and compounded it in safe, income-producing securities, in due time he'd have money coming in daily, weekly and monthy just like the rich guy. In brief, the little guy would become a financial winner instead of a pathetic loser.

(4) Today's tax system militates against the trader. If you make a profit, you pay a tax on that profit. Furthermore, your profit is taxed at your regular income tax rate. But if you sustain a loss, you can only write off $3,000 a year against those losses. So the system works against the trader.

(5) For some reason, few people understand the mathematics of investing. If you buy a stock at $20 per share, and the stock drops to $10, you've lost 50% of your money (actually more because of commissions). To get back to your original investment, you've got to make 100% on your money. If you take into account taxes and commissions, you've obviously got to buy a stock that will go up more than 100% or a stock that will more than double. As any veteran will tell you, this is very difficult.

(6) Conclusion: The only time the average investor should go outside the basic compounding system is when a given market offers outstanding values. I judge an investment to be a great value when it offers (1) safety, (2) an attractive return, and (3) when there's a good chance that the given investment will appreciate in price (in other words, when the item is undervalued). At all other times, for the reasons listed above, the compounding route is certainly safer and probably a lot more profitable. I might add that the process of placing money in muni cash funds also eliminates the problem of making decisions (and the average investor all too often makes a wrong decision).

The real problem facing investors is that of greed (or envy). If your neighbor or your boss or your best buddy is making money in soybeans or stocks and you are sitting with a money market fund, you may find yourself losing sleep and asking, "What am I doing? I'm playing it safe while that idiot Charlie down at the office is making a bloody fortune." So you pull out your money, jump into a few stocks and within six months -- you're showing a 25% loss on your money.

Don't do it; stick to your own system. One of the criteria for building wealth is that you MUST NOT LOSE MONEY. Jumping in on the stock or bond market when they do not represent great value is the perfect way to lose money. Repeat to yourself five times, "I only buy stocks or bonds when they are great values. Are stocks and bonds great values now? If they aren't, I'm not interested -- even if Charlie is getting richer by the day." End of lesson.

NOTES & QUOTES: No matter what I write and no matter what subject I cover, I receive happy letters, angry letters, letters of agreement and disagreement from subscribers. I read 'em all, and am happy to get them (of course, I like the ones that agree with me the best). Unfortunately, much as I'd like to, I can't answer most of these Letters. I have over 10,000 subscribers now, and a lot of you are serious letter writers. That means that I get up to a dozen letters a day. I just can't answer them all and do the work for the Letter. So I scrawl notes on some letters and return them, some I just thank, but most I simply can't answer. But that doesn't mean I don't like to hear what you have to say -- good or bad.

Occasionally I get a letter complaining about my habit of including personal items like my daughter's marriage. "I subscribed to read about the markets, not to hear about your daughter or low calorie soup or your opinion of New York." That's a valid complaint. My only answer is I've been writing these Letters since 1958, and when you've been doing this kind of work for 30 years you need to put some human interest in your writing (at least I do). To me, life is more than which way the market went last week. I have an irresistible urge to tell people what I've seen, what I've learned, what I'm interested in.

Confession: I started out wanting to write the great American novel (I was an English major in college), so you know I'm a frustrated novelist at heart. But the markets fascinated me, and somewhere along the line I got waylaid. No, the truth is that I found reality more interesting than fiction. So please dear readers, indulge me. Or if you want, just call me eccentric.

* *

Debt: The addition of Social Security surpluses to the annual US deficit provides us with a deceitful figure, a figure that makes the deficit look better than it is. But the real debt additions can be seen by examining the year-to-year additions to the national debt. Last year the increase in the debt was $250 billion. Now, a bit more than halfway through the fiscal year, the federal debt has already increased by $175 billion. Talk about compounding!

* *

First the S&Ls and now the Federal Housing Administration, which insures $275 billion of US mortgages. The first audit in 55 years shows that reserves of the FHA have dwindled to $2.8 billion, enough to cover a mere five months of claims. After that, as the FHA goes into a negative position, it's Uncle Sam (i.e., you and me) who pick up the tab. All of which constitutes major new additions to the Federal debt. Note: Government examiners expect the fund, which plunged into the red in 1987, to "erode substantially" over the next two years.

* *

Just received the latest report from my old buddy, Chevalier Harry D. Schultz (very sorry we missed you in Europe, Harry). States the Chevalier, "I fear USSR will now con the West into accepting their rubles, calling them convertible, which nobody will ever be able to convert. Thus, we'd be funding the entire Soviet system. Whatever the exchange rate, it'll be a gift to Moscow from you. You are being set up."

* *

Russell comment: Last week I saw a TV documentary on the Russian prison system, a film which included many clips that were smuggled out of Russia at great risk. Unbelievable cruelty, inhuman conditions, and all, of course, done in secret. If I were President, I wouldn't offer the Russians a fig leaf unless they allowed open inspection of their prisons. How a society treats its prisoners tells a huge amount about that society.

* *

"Gorby-mania" has swept West Germany. The Germans love Gorby, and Gorby loves the idea of all-out trade with Germany (plus of course, German financing). It seems to me that Gorby sees German trade and technology as his best chance of moving the Russian economy at least part way into the 20th century. Germany sees Russia as a potentially huge market, and maybe as a way to stiff-arm the rest of the world into reuniting the two Germanys (an act which would terrify most of Europe).

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It was just about three years ago that I underwent a quintuple bypass operation. On the same day that I was operated on, my friend, Dr. Burt Weiderholt also underwent a bypass. Talk about a wild man -- Burt went swimming in the ocean two weeks after his operation (I went to a party 10 days after my own operation). Last week I ran into Burt, who I hadn't seen in about six months. "I just climbed Mt. Kilimanjaro in Africa," he said proudly. "How high did you go, madman?" I asked. "The whole 19,000 feet." So for all you out there who have had or will have a bypass, now you know. Your quality of life definitely will improve after that surgery.

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There's a new magazine entitled *Garbage*. It's a serious magazine, and it certainly deals with a growth industry. Speaking of garbage, the pile of garbage building up on Staten Island, NY is fast becoming one of the world's great edifices. It's already taller than the Statue of Liberty and will soon be higher than the Great Pyramid of Cheops (at 500 feet).

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Seminar in August: There's an outstanding seminar coming up August 16-20 at the Fairmont Hotel in the glorious city of San Francisco. The seminar will be put on by my good friends, the Githlers of *Investment Seminars Inc.* Speaking at the seminar will be John Dessauer, Richard Band, Craig Corcoran, Al Frank, Charles Allmon, Norm Fosback, Michael Murphy, Jay Schabacker, Geraldine Weiss, Robert Kinsman, Harry Browne, Mark Hulbert, Lou Rukeyser, plus more. Of course, I'll be speaking too. For info call 813-955-0323 or write ISI, 1543 Second St., Sarasota, Fl 34236. By the way, if you like Chinese food or seafood or any kind of fine food, you'll be in heaven in San Francisco.

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Omnigraphics: (Penobscot Building, Detroit, MI 48226) is reprinting some of the Dow Theory classics including *ABC of Stock Speculation* and *Stock Market Barometer*. If you'd like a copy of one of these rare books, write for info.

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Predictions, a journal out of Bethesda, MD, offers a list of the "worst investments for the balance of 1989." Here are a few items (their opinions, although I don't disagree) : (1) New issues of coins by the US government; (2) High premium privately minted coins; (3) Uninsured CD-like notes -- or high yielding subordinated capital notes that are not insured, even though the issuing thrift may be; (4) Fake no-load funds or funds with "contingent" deferred sales charges. These are charges, often as much as 6%, which you must pay when you sell the fund; (5) Costa Rican investments. Costa Rica has a very odd fraud law. Fraud is deemed to have occured only if both the perpetrators and the victim were actually in Costa Rica; (6) Diamonds and gemstones (*Predictions* admits that diamonds are in a bull market, but they add the old saw (undoubtedly true) that the public buys diamonds at retail and sells them at wholesale); and (7) Buying gold "directly from the mine" (Says the magazine, "What you're really buying is an interest in a pile of dirt which contains gold ore. A company takes your $250 and promises to send you the refined gold in a year or so, which it rarely does."). (8) A Russell addition: new issues of US postal stamps. This is a total waste of money. Often these stamps are sold back to dealers in bulk at below face value. With few exceptions, US stamps issued after 1950 are worth little more than their face value (and don't tell me about their catalogue price).

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Trivia Dept: According to Scripps Memorial Hospital in La Jolla the average American walks 70,000 miles during his lifetime. No wonder my feet hurt. . . . What's today's hottest food? Peanut butter. Last year Americans consumed 700 million pounds of peanut butter, up a fat 20% from the year before. Adults prefer chunky, children prefer creamy. . . . The average Japanese

house is 900 square feet. A 1,500 square foot house is considered a luxury.

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I've been saying this for almost two years, but I'll repeat it: defense spending is most definitely heading down. The declining Soviet threat, the impetus of arms control, the pressure to raise world living standards and the sheer, unmanageable cost of armaments are dictating a world drop in defense spending. The battles of the future will unquestionably be on the economic front. James Blackwell, deputy director of Political-Military Studies at the Center for Strategic and International Studies (Washington, DC), predicted that by the mid-1990s US military spending could drop to 3% of GNP, a post-WW II low (it's been around 5%). Which state will bear the brunt of the cutbacks? California, which now gets 20% of Pentagon procurements. It's already happening: Northrup plans to cut 3,000 employees, Hughes Aircraft is firing 6,000, Grumman is cutting 3,100 jobs, Textron's Bell Helicopter is laying off 2,500 workers.

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The shenanigans of some of the busted S&Ls would be comical if they weren't so tragic -- and expensive. For instance, Seapointe S&L of Carlsbad, Ca., lost half of its depositors' money in a single day. Seapointe shorted $10 billion of T-bonds. When prices rose, Seapointe took a loss of $15.9 million, part of the speculative losses that wiped out $24 million of the S&L's $32 million in deposits. An S&L in Vernon, Tx., had so many airplanes that locals referred to it as the Vernon Air Force.

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Things to Come? Meeting last week in Strasbourg, France, the European Parliament adopted proposals for a new law which states that half or more of entertainment shows in Europe must be produced in Europe. Trade representative Carla Hill stated that the move "would almost certainly have a disastrous effect on the US industry's European earnings."

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The S&L bailout guestimates started at around $13 billion. Then they went to $100 billion. Latest figures are staggering. FDIC chairman, William Seidman, now states that including interest the cost will be $300 billion (he estimated $15 billion three years ago). The General Accounting Office is talking about a figure above $300 billion.

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What's the story on selling a house if you're over 55? The story is that you have a once–a–lifetime exclusion of $125,000 -- IF you lived in that house for three of the last five years. You do not have to buy another house to get the exclusion. For instance, if you sell your home for $285,000 you can take the $125,000 exclusion. This reduces your sales price to $160,000, and your realized gain is then only $160,000 minus your basis. Not a bad deal if you're over 55 and really want to take the money and run. By the way, this exclusion applies even if only one spouse meets the age and residence requirements. Beware - once you use the exclusion on a joint tax return, you are barred from using it again during your lifetime, even if the house sold was in the other spouse's name.

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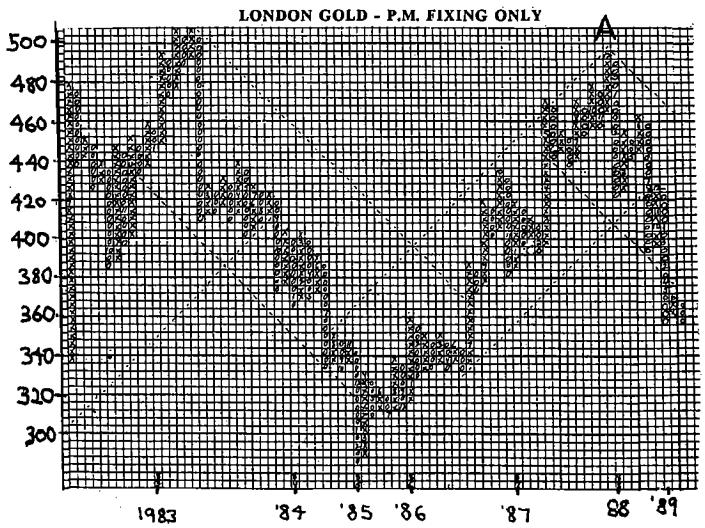
GOLD: Gold seems to have found support at 360 (London p.m. fix). Despite all kinds of dire predictions of $300, $250 and even $200 gold (some of these predictions, would you believe, come from former gold-bugs), the metal is starting to act better.

There aren't many certainties in the market, but one certainty is that gold and bonds are not going to go up together, at least not for long. But that's exactly what they did on the week ending June 23. Can this action continue? The answer is "No." One or the other of these two items wil have to take the low road.

Here's a point & figure chart courtesy of *Chartcraft*, New Rochelle, NY. The chart is a 4x12 reversal chart which simply means that each box represents 4 points on gold and a reversal on the chart will only occur if gold moves 12 points or more in either direction.



The chart shows that a downtrend has been in force since the November 1987 high of 496 (A on chart). From A gold has declined rather steadily, hitting a low of 360 in May of 1989 and again in June. Since the 360 low gold has bounced away from that level on a few occasions, but each time it has returned.

Now gold is in position to register a reversal, at least a short-term reversal. To get such a reversal, we'd have to see a London p.m. fix at 376 or better. If spot gold hits 376 it would be in position to test overhead resistance at 396-400.

So why argue the merits of gold, silver, inflationary hedges, real money, etc. It's as simple as this -- if gold hits 376 it will be a plus for the yellow metal. If gold then pushes over 400 the situation will start to look interesting (but more ominous than interesting to Alan Greenspan). So let's let the market do the talking.

The low for the gold/common stock ratio was struck on June 2 at 200 (i.e., gold divided by the NYSE Composite Index). During an important gold advance, this ratio will always rise. All I can say, so far, is that the ratio hasn't gone lower than the June 2 low (latest reading 205). Gold-philes would not want to see this ratio drop below 200.

LATE NOTES: The split in professional market opinion at this time is almost startling. Most of the value-oriented pros are careful, cautious or downright bearish at this time. The technicians, on the other hand, tend to be optimistic since almost all the major market indicators are now at recovery highs.

There is no questioning the fact that the economy is slowing, with car sales down, home sales down and retail sales sluggish. But the prevailing attitude towards the slowdown remains remarkably optimistic, and you can almost hear the cheers as each new negative business statistics hits the headlines.

The optimisim, of course, is based on the widely-accepted thesis that the worst that lies ahead is the "soft-landing." This is another way of saying that the economy may slow down, but that is all it will do (i.e., merely "a decline in the growth rate"). Furthermore, such a slowdown will be downright beneficial for the nation, since a slowdown will do little more than collapse interest rates.

In all, it's a very pat view of the situation. But the bear state that the worm in the big juicy apple is the debt situation. Almost half of all corporate earnings now go towards debt payment, and this nation has never entered into a business "slowdown" while carrying this kind of debt burden. Optimists claim that the bulk of the corporate debt is in stable, consumer-oriented industries so there is nothing to worry about, even in the event of a stiff recession. Pessimists laugh this off as wishful thinking. The test lies somewhere ahead.

NEXT MAILING: Wednesday, July 12